

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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CC:PSI:B03

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January 12, 2017

### Legend

X =

State =

D1 =

D2 =

Year1 =

Year2 =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Trust6 =

Trust7 =

Trust8 =

Trust9 =

Trust10 =

Trust11 =

Trust12 =

Trust13 =

Trust14 =

Trust15 =

Trust16 =

Trust17 =

Trust18 =

Trust19 =

Trust20 =

Trust21 =

Dear :

This letter responds to a letter dated July 7, 2016, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### FACTS

X was organized under the laws of State on D1 and elected to be an S corporation effective D2. The information submitted states that the Form 2553 that X filed was not signed by the current income beneficiaries of Trust1 through Trust21, which were qualified subchapter S trusts (QSSTs) within the meaning of § 1361(d). Therefore X's S corporation election was invalid.

X also represents that in Year1 and Year2, Trust17 failed to distribute all of its income (within the meaning of § 643(b)) in accordance with the requirement in § 1361(d)(3)(B). Trust17's trust agreement did not require that all income from the trust be distributed currently to the trust beneficiary. Had X's S corporation election been valid, the failure of Trust17 to distribute all of its income currently to its income beneficiary in Year1 and Year2 would have terminated X's S corporation election. X represents that Trust17 has since distributed all of the undistributed income to its beneficiary.

X represents that neither the invalid election nor Trust17's failure to distribute the income was intentional or motivated by tax avoidance. X further represents that it has filed consistently as an S corporation since D2. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

### LAW AND ANALYSIS

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(3) defines a QSST to mean, in part, a trust all of the income

(within the meaning of §643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(a)(2) provides that an S corporation election shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(a)(2)(i) provides that an S corporation election is not valid unless all shareholders of the corporation at the time of the election consent to the election in the manner provided in 1.1362-6(b).

Section 1.1362-6(b)(2)(iv) provides that in the case of a trust described in section 1361(c)(2)(A) (including a trust treated under section 1361(d)(1)(A) as a trust described in section 1361(c)(2)(A)(i) and excepting an electing small business trusts described in section 1361(c)(2)(A)(v)), only the person treated as the shareholder for purposes of section 1361(b)(1) must consent to the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary (QSub), as the case may be, or (B) to acquire the shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the

corporation will be treated as an S corporation or a QSub, as the case may be during the period specified by the Secretary.

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was invalid on D2. In addition, had X's S corporation election not been invalid, we conclude that its S corporation election would have terminated at the end of Year1, and again at the end of Year2, when X had an ineligible shareholder due to Trust17's failure to distribute (and lack of a requirement to distribute) all of its income currently to its income beneficiary. We also conclude that the circumstances resulting in the ineffectiveness and termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), X will be treated as an S corporation from D2 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d) for reasons not addressed in this letter.

This ruling is conditioned on X filing consents to the S corporation election signed by the beneficiaries of Trust1 through Trust21 with an effective date of D2 with the appropriate service center within 120 days from the date of this letter. Those consents may also include any missing information as required by § 1.1362-6(b)(1). A copy of this letter should be attached to the consent statements.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, we express or imply no opinion as to whether X was otherwise eligible to be treated an S corporation.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

Holly Porter  
Branch Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter  
Copy for § 6110 purposes